Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
National Exchange Carrier Association, Inc.	)	
2003 Modification of Average Schedule	)	DA 02-2626
Universal Service Formulas	)	

Comments of the ICORE Companies

The consulting firm of ICORE, Inc. (ICORE), on behalf of many small "average schedule" incumbent local exchange carriers (ILECs),[1] offers these comments in the above-captioned proceeding. ICORE provides a variety of consulting, regulatory and network-related services to a number of small ILECs serving rural and suburban America.

[1] ILECs participating in this filing include: Adams Telephone Cooperative, Golden, IL; Bentleyville Communications Corporation, Bentleyville, PA; Breda Telephone Corporation, Breda, IA; Buggs Island Telephone Company, Bracey, VA; Casey Mutual Telephone Company, Casey, IA; Community Service Telephone Company, Winthrop, ME; Cooperative Telephone Company, Victor, IA; Crosslake Communications, Crosslake, MN; Dunbarton Telephone Company, Dunbarton, NH; Farmers Cooperative Telephone Company, Dysart, IA; Ft. Jennings Telephone Company, Ft. Jennings, OH; Harmony Telephone Company, Harmony, MN; Hayneville Telephone Company, Hayneville, AL; Hot Springs Telephone Company, Kalispell, MT; Ironton Telephone Company, Coplay, PA; Lavaca Telephone Company, Inc., Lavaca, AR; Middle Point Home Telephone Company, Middle Point, OH; Northern Telephone Company, Wawina, MN; Palmerton Telephone Company, Palmerton, PA; Pattersonville Telephone Company – OH, Carrollton, OH; Pennsylvania Telephone Company, Jersey Shore, PA; Prairie Grove Telephone Company, Prairie Grove, AR; Prairie Telephone Company, Breda, IA; Rochester Telephone Company, Rochester, IN; Ronan Telephone Company, Ronan, MT; Stayton Cooperative Telephone Company, Stayton, OR; Summit Telephone Company, Fairbanks, AK; Swayzee Telephone Company, Swayzee, IN; Venus Telephone

I. INTRODUCTION

The Commission, in Public Notice DA 02-2626, released October 11, 2002, requests comments on the National Exchange Carrier Association's (NECA's) proposed modification of its average schedule local switching support (LSS) and high cost loop (HCF) Universal Service Fund (USF) formulas. If approved, these formulas will be used to calculate LSS and HCF payments for average schedule companies for the 2003 calendar year.

NECA's average schedule formulas, which provide interstate access and universal service support payments to many small, rural ILECs, are crucial to these companies' survival. These ILECs, some serving as few as 40 access lines, often lack the resources to perform — or have performed on their behalf — costly, complex and time consuming individual cost separations studies. The average schedule formulas are a surrogate for these cost studies.

It is therefore essential that all of NECA's formulas be developed in strict accordance with Section 69.606(a) of the Commission's rules, which reads, in its entirety:

> § 69.606 Computation of average schedule company payments
>
> (a) Payments shall be made in accordance with a formula approved or modified by the Commission. Such formula shall be designed to produce disbursements to an average schedule company that simulate the disbursements that would be received pursuant to § 69.607 by a company that is representative of average schedule companies.

Corporation, Venus, PA; Westside Independent Telephone Company, Breda, IA; West Side

The average schedule formulas now encompass common line; local switching; line haul distance sensitive; line haul non-distance sensitive; intertoll switching; special access; rate-of-return; SS7 signaling; universal service contributions; common line, line port shifts; common line transport interconnection charge (TIC) shifts; equal access; network administration; local switching support (LSS) and high cost loop (HCF) support.

If any of these elements fail to simulate the interstate payments — either for access or USF — that would be received by similarly situated cost companies, the Commission's rules would be violated and the average schedule companies could be financially harmed.

II. LSS FORMULA

Local Switching Support is a component of the Commission's federal universal service program which recognizes the proportionately higher switching costs of small ILECs. These costs were once loaded into the interstate cost separations process via "DEM weighting," and recovered through interstate traffic sensitive access charges.

Over the past several years, implicit subsidies have been replaced by explicit subsidies. That is, mechanisms such as DEM weighting have been removed from both interstate separations and access charges, causing access charges to decrease. The revenue requirement associated with DEM weighting was moved into the Commission's explicit universal service program, to be paid to small ILECs not through access charges, but through USF contributions.

Small ILECs continue to be appropriately compensated for their proportionately higher switching costs, but through USF contributions rather than access charges.

Telecommunications, Morgantown, WV; Wilderness Valley Telephone Company, Wawina, MN

NECA's LSS formula, by simulating for average schedule companies the local switching support payments that would be made to similarly situated cost companies, complies fully with Section 69.606(a) and should be approved.

III. USF EXPENSE ADJUSTMENT FORMULA

A. The Commission Must Adopt NECA's EAPL Formula, To Comply With Its Own "Payment Simulation" Rule

This formula calculates high cost loop support payments for average schedule companies. It is similar to local switching support in that it recognizes that many small, rural ILECs have proportionately higher loop costs, just as LSS recognizes the higher switching costs of these companies. As with local switching support, a mechanism was once built into the interstate cost separations process to assign a higher proportion of loop, and related non-traffic sensitive costs, to the interstate jurisdiction.

This mechanism was the Subscriber Plant Factor, or SPF, and could allocate as much as 85% of an ILEC's non-traffic sensitive (NTS) costs to interstate. Like DEM weighting, this implicit subsidy increased interstate access charges, and was eventually replaced by an explicit USF subsidy. SPF was transitioned downward to a flat 25% allocator, and high cost loop support was implemented to recognize the higher loop costs of small ILECs.

In both cases — DEM Weighting and SPF — an implicit subsidy built into the separations process was eliminated. In both cases, the Commission continued to recognize that the underlying need for these mechanisms was valid. That is, smaller ILECs have proportionately higher local switching costs and loop costs, and they are entitled to recover their proportionate share of these costs through the interstate jurisdiction.

In both cases — DEM Weighting and SPF — an explicit subsidy mechanism was implemented to replace an implicit one. Companies with high switching costs and high loop costs continued to properly recover those costs, but through USF contributions rather than access charges. LSS and high cost loop formulas, developed per Section 69.606(a) of the Commission's rules, assured that average schedule companies recovered their high switching and loop costs in the same proportion as representative cost studies.

Average schedule companies still do, at least for LSS. Beginning last year, however, the Commission seems to have adopted a new standard for average schedule high cost loop support, a standard which appears contrary to its own rules and long standing practice, and is extremely harmful to some of the nation's smallest ILECs.

On October 1, 2001, NECA proposed its Expense Adjustment Per Loop (EAPL) formula "as the best available means for simulating the HCF payments that average schedule companies would receive if they were to perform Part 36 cost studies".[2] The Commission rejected NECA's EAPL formula in favor of a CPL formula that NECA had included only as support for "a lower bound of increased support payments to average schedule companies."[3]

The Commission's rejection of NECA's EAPL formula would not be so troubling to the ICORE companies had the Commission found that the CPL formula somehow better complied with its Section 69.606(a) "payment simulation" rule. In fact, however,

[2] See National Exchange Carrier Association, Petition For Reconsideration, Federal-State Joint Board on Universal Service, Proposed 2002 Modification of Average Schedule Formulas, August 29, 2002, Page i. (NECA Petition)
[3] Id. Page i.

the Commission made, "for the first time, an unprecedented and wholly unsupported determination that 69.606(a)'s 'payment simulation' criteria applies (sic) only to access formulas and does not apply to the HCF formula."[4] (emphasis added)

The Commission, for the first time ever, rejected its long-standing written rule — a rule that NECA had followed, and the Commission had used to adopt or reject every NECA average schedule formula since the early 1980's — in favor of a "cost per loop" rule that has never been proposed, reviewed, commented upon, or written into any formal Commission document. The average schedule companies represented herein have long relied upon average schedule formulas that simulate the payments that would be received by representative cost companies. They fail to see any rationale for the Commission's rejection of its long-standing rule for the HCF formula.

After all, as stated above, both LSS and HCF loop support were designed to recover revenue requirements that were transferred from access to USF, in order to make these types of support elements more explicit. Both are an integral part of the Commission's universal service program. And both are paid to average schedule companies through formulas developed by NECA and approved by the Commission. But while LSS continues to be properly governed by the Commission's "payment simulation" rule, HCF now falls under a kind of phantom rule that doesn't exist in Part 36, Part 69 or in any other Part of the Commission's rules.

The Commission has not micromanaged LSS by developing a cost per switch, or a weighted cost per switch, or any other element that might be a component of LSS. Instead, it has rightfully used its "payment simulation" criteria to review and approve NECA's LSS formula. The ICORE companies completely fail to understand, then, why

[4] Id. Page i.

for HCF the Commission has substituted a cost per loop methodology in place of the "payment simulation" criteria required by its very own rules.

All other NECA average schedule formulas, access and USF, including common line; local switching; line haul distance sensitive; line haul non-distance sensitive; intertoll switching; special access; rate-of-return; SS7 signaling; universal service contributions; common line, line port shifts; common line transport interconnection charge (TIC) shifts; equal access; network administration; and LSS, are developed and approved in accordance with Section 69.606(a) of the Commission's rules.

It is absolutely impossible for the ICORE companies to understand how some 14 formulas can be properly administered under a Commission rule that goes back 20 years, while one — HCF — is singled out for treatment under a rule that does not exist. The Commission must reverse its position, and review and approve NECA's proposed EAPL formula using its Section 69.606(a) "payment simulation" rule.

B. The Commission Must Adopt NECA's EAPL Formula, In Accordance With the Most Fundamental Principle of Universal Service Support

High cost loop support (HCF) is at the very heart of the Commission's universal service support program. It is the original USF element, the one designed to assure the decades old objective of universal service at affordable rates. HCF compensates small, rural companies for their proportionately higher loop costs, to help keep local rates affordable to their customers.

HCF, and later, LSS, were implemented for small, rural companies, those with no economies of scale or scope, with long loops and higher local switching costs. Such companies generally serve rural areas with relatively few access lines, few business customers, and low revenue-generating residential customers. They serve the kind of high cost, low profit exchanges that have consistently been sold off in recent years by the large Regional Bell Operating Companies.

Average schedule companies in general, including those in this filing, are amongst the smallest, most rural ILECs in the nation. The Bell companies have never been interested in serving their areas, and their exchanges are generally not attractive to CLECs, either. Without the dedicated efforts of these small, average schedule companies, many rural customers would have no telephone service at all.

Universal service support has helped these companies — cost as well as average schedule — provide high quality, affordable service to many of the most rural and insular regions of our country. This was the original intent of the Commission's USF program. While support for schools and libraries, rural health care facilities, low income subscribers and others have been added in recent years, the Commission must not lose sight of the primary, fundamental purpose of universal service support: to promote universal service at affordable rates.

Small ILECs — average schedule and cost — are often the only providers of universal service at affordable rates to rural America. They must continue to receive appropriate levels of support in order to provide modern, state-of-the-art telecommunications services to their customers at reasonable prices.

Small average schedule companies have been deprived of much needed HCF support by the Commission's adoption of its cost per loop formula. NECA's proposed EAPL formula will produce HCF payments of $37.59 million, payable to 399 average schedule study areas, for the year 2003. This will represent a much needed 13.9 million increase over 2002 payments. The Commission's CPL formula will produce only $31.03 million, payable to 369 companies, for 2003.[5] In 2002, the Commission's rejection of NECA's EAPL formula in favor of its CPL formula deprived average schedule companies of about $10 million.[6]

The amounts involved here are very significant to the average schedule companies that are attempting to provide high quality, affordable telecommunications services to rural America. But they are miniscule in terms of the total Universal Service Fund, which is approaching $<u>5 Billion</u>. A $13.9 million increase for the nation's smallest companies — a much needed increase in terms of providing universal, affordable telecommunications services to rural America — pales in comparison to many of the fund's other elements, including the $2.25 Billion earmarked for schools and libraries.

The Commission must consider the needs of small ILECs and their rural customers in approving HCF payments. It must consider the fundamental reason for high cost support, which is to promote universal service at affordable rates. Small, rural average schedule companies need appropriate levels of such support to accomplish this goal.

NECA's EAPL formula produces the appropriate levels of support, in that it "simulates payments" to representative cost companies. And while a $13.9 million increase may on the surface seem large, it is a tiny fraction of a $5 Billion fund. The Commission should therefore approve NECA's EAPL formula, in that it does not unduly increase the fund, yet comports with the most fundamental principles of its universal service program.

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[5] See 2003 NECA Modification of Average Schedule Universal Service Formulas, October 1, 2002, Page I-14. (2003 NECA Modification)

C. The Commission Must Adopt NECA's EAPL Formula, To Assist The Very Smallest Companies In Their USF Efforts.

Ironically, those average schedule companies most severely harmed by the Commission's rejection of NECA's EAPL formula in favor of a CPL formula are the very, very smallest. Of 16 companies losing HCF support in 2002, 15 have fewer than 250 access lines, and eight of them have fewer than 100 access lines.[7]

These are the very companies that most need HCF support. They serve as few as 38 access lines, often with about one customer per square mile. By definition, they have proportionately higher switching and loop costs than larger ILECs serving more densely populated areas. These very tiny average schedule companies obviously have no economies of scale or scope, no large business customers, and few, if any, high volume or high revenue producing residential customers.

They are far too small to "game the system," or to exert any kind of monopolistic control over their customers. In fact, they are the only entities willing to serve these high cost, low density, unprofitable rural areas. Verizon and Quest have for years been unloading similar — albeit generally larger — exchanges. CLECs are not clamoring to provide service in these most rural and insular areas. These tiny companies need financial help to provide service at reasonable prices.

Yet the Commission, in adopting its CPL formula for 2002 over NECA's EAPL formula, has caused devastating financial harm to these companies. These tiny ILECs, serving a handful of customers in various parts of rural America, had reasonably

[6] NECA Petition, Page ii.
[7] NECA Petition, Attachment 1, also included here as Attachment 1.

relied on NECA's previous HCF formulas to provide them with the necessary support to help meet the Commission's universal service goals.

Now, in 2002, they have been deprived of as much as 43% of their HCF payments by the Commission's formula. One 40 line company represented herein saw a reduction from $10,492 annually to $5,995, a loss of <u>$112.43 per access line</u>. For a 40 line company, this is a staggering blow to its efforts to provide quality service at affordable rates. (See letter of September 12, 2002 from Wilderness Valley Telephone Company to Senator Paul Wellstone, Attachment 2).

The ICORE companies are certain that the Commission did not intend to severely harm the nation's smallest ILECs — the ones needing USF support the most — in this manner. The Commission, in order to rectify this situation, should adopt NECA's EAPL formula, which will help bring HCF payments for these tiniest of companies up to their appropriate levels.

Again, the amounts involved are miniscule when compared to a $5 Billion fund, but they are crucial to the survival of the nation's smallest average schedule companies.

IV. <u>CONCLUSION</u>

The Commission, in reviewing and approving NECA's proposed 2003 LSS and HCF formulas, should follow its long-standing "payment simulation" rule. This rule has long governed NECA's development of average schedule access and USF formulas, and the Commission's approval thereof.

To invoke a different rule for HCF is an arbitrary and capricious violation of Commission rules and policy. Application of a different rule for HCF severely damages the most basic principles of USF, and harms the very smallest companies — the ones truly in need of support — the most.

For these reasons, NECA's proposed LSS and HCF (EAPL) formulas should be approved for use in 2003.

Respectfully submitted,
ICORE, Inc.

Jan F. Reimers
President
326 S. 2nd Street
Emmaus, PA 18049
610-928-3944